SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1900.

No. 148.

GEORGE H. SCOTT,
Plaintff in Error,

vs.

PARRY L. DEWEESE (substituted for W. A. LATIMER), Receiver of First National Bank of Sedalia, Mo.,
Defendant in Error.

In error to the United States Circuit Court of Appeals for the Eighth Circuit.

STATEMENT OF CASE.

This action was brought in the United States Circuit Court for the Western District of Missouri by the receiver of the First National Bank of Sedalia, Mo., to recover an assessment made by the

comptroller of the currency upon 50 shares of stock claimed to be held and owned by Scott, plaintiff in error. The original capital of this bank was $100,000. On September 6, 1890, the shareholders, by a vote of the owners of two-thirds of the capital stock, resolved to increase said capital to $250,000. Sometime in said month of September the officers of said bank informed and represented to Scott as follows: "That said bank contemplated increasing its capital stock from $100,000 to $250,000; that said intended increase of capital was made desirable on account of the increasing business of said bank; that said bank was in a flourishing condition and earning large dividends upon its capital stock and then had a surplus of $50,000 over and above its capital stock and all liabilities; that from said surplus such dividends would be declared as would make each of the 2,500 shares of stock worth the sum of $108." (Transcript of Record, folios 10, 11.) Relying upon these representations Scott subscribed for 50 shares of said proposed increase of $150,000, and in October, 1890, he deposited in said bank, as by statute he was required to do, the sum of $5,400 and at the time he deposited this money it was the understanding between Scott and the bank that said $5,400 was to be held by the bank and applied in payment of defendant's subscription when all of said proposed increase of capital was subscribed for and the money therefor paid into said bank and when the issue of said shares could be legally made. The bank gave Scott a receipt for the money so deposited. On October 25,

1890, the bank delivered to Scott a certificate for 50 shares of this pretended increase of capital and then and there represented to Scott that the increase had been legally made, that the full amount of the increase had been subscribed for and paid in, and relying upon these representations Scott accepted the certificate and continued to hold it until the bank closed.

In September, 1890, and for many months prior thereto and ever afterwards the bank was wholly insolvent and had no surplus whatever. Its capital was all lost and much more besides. It was earning no dividends. Only two-thirds of the attempted increase was ever paid for, and the officers of the bank made false entries in the books and records of the bank for the purpose of showing an apparent surplus and from this surplus declared a large dividend to themselves and turned in this dividend in pretended payment for about one-third of said increased stock. "The whole transaction was a sham and was done for the purpose of bolstering up an insolvent institution, by obtaining large sums of money from the subscribers for the increased stock and for the further purpose of watering the capital stock of said bank and permitting the officers thereof to appropriate to themselves, without paying anything therefor a large part of said pretended increase." (Transcript of Record, fol. 11.)

On January 17, 1891, the comptroller of the currency issued his certificate and certified that the bank had increased its capital to $250,000, that the

increase had been paid in in full and approved the increase. He based his action wholly upon a notification received from the bank that the whole amount of the proposed increase had been paid in, and at the time he approved the increase he knew "that more than the entire capital of said bank was then loaned to its president, and that the amount so loaned had been constantly increasing for several years up to said January 17, 1891, by adding interest, which was not paid to the notes evidencing such loans on the renewals thereof." (Transcript of Record, fol. 9.)

The bank continued to do business with a pretended capital of $250,000 down to the time when it closed its doors on May 4, 1894—a little less than 3 years and 4 months, and during this time it paid dividends amounting to 18 per cent, these dividends being paid out of the money paid in by the subscribers for new stock.

Of the false and fraudulent representations and acts of the bank Scott had no knowledge whatever until long after the bank had closed its doors, nor had he any information whatever that could in any way have created a suspicion thereof.

"The books and records of said bank during all the time after said Oct. 25, 1890, have shown and it has been made by them to appear that all of said pretended increase of capital was paid in; that from a time prior to said Oct. 25, 1890, until said bank closed, the books and records of the bank were systematically, skillfully and cunningly falsified by said officers and so kept that the defendant could

not, by the *utmost diligence*, ascertain the true condition of said bank." (Transcript of Record, fol. 11.)

As soon as Scott discovered that the full amount of the increase had not been paid in he disclaimed and denied that he was or ever had been a stockholder. The answer contains the usual allegations of deceit. Scott never had any interest in or connection with said bank except as herein stated.

In the Circuit Court the receiver moved for judgment on the pleadings and the same was granted. No opinion was filed by the Circuit Court. Scott sued out a writ of error to the Circuit Court of Appeals for the Eighth Circuit, the majority of which Court affirmed the Circuit Court, and by writ of error the questions involved are now before this Court.

It is claimed by plaintiff in error that the facts set out and admitted in the pleadings show: 1st. That the pretended increase of capital of the bank was invalid and that plaintiff in error never became liable as a stockholder. 2nd. That the fraudulent misrepresentations which induced the plaintiff in error to contract for the shares of new stock, which were issued to him, entitle him to repudiation and rescind that contract; 3rd. That the subscription of plaintiff in error was made dependent upon the existence and performance of certain conditions which never existed and have never been performed and therefore his subscription never ripened into stock ownership. These questions are brought before this Court by the following

ASSIGNMENTS OF ERROR:

First. That the Court erred in holding that where the stockholders of a National bank decide, with the approval of the comptroller, to increase the capital stock therein by a named amount, the clause of Revised Statutes, Chapter 5142, to the effect that no increase shall be valid until the whole amount is paid in does not create a condition, express or implied, that shares subscribed and paid for in full are not to be held valid unless the entire amount of the proposed increase is subscribed and paid for in full, but refers only to the actual increase created by a subscription for a given number of shares, which must be paid for in full to render it valid.

Second. The Court erred in holding that the amount of the proposed increase decided upon and approved by the comptroller merely fixes the maximum increase authorized, and each subscription thereto when paid up in full becomes valid and binding until such maximum is reached.

Third. The Court erred in holding that the liability of a stockholder in a National bank for assessments made by the comptroller on its insolvency is not dependent upon the contract of subscription between the stockholder and the corporation, but is created by statute for the benefit of the bank's creditors, and can neither be modified nor released by any act of the corporation.

Fourth. The Court erred in holding that one who has been induced by false representations of its officers to subscribe to the increased stock of a

National bank, though without knowledge of the fraud or means of ascertaining it, cannot after the bank has been placed in liquidation exercise his option to rescind the contract of subscription as against the bank's creditors.

Fifth. The Court erred in holding that the facts alleged in the answer did not constitute a defense to the cause of action stated in the complaint.

ARGUMENT.

1. *No valid increase of capital stock was ever made since the whole amount of the proposed increase was not paid in.*

Of the principal questions in this case, the first involves the interpretation of Sec. 5142, Rev. Sts. U. S., relating to National banks. This section is as follows:

"Any association formed under this title may, by its articles of association, provide for an increase of its capital from time to time, as may be deemed expedient, subject to the limitations of this title. But the maximum of such increase to be provided in the articles of association shall be determined by the comptroller of the currency; *and no increase of capital shall be valid until the whole amount of such increase is paid in, and* notice thereof has been transmitted to the comptroller of the currency, *and* his certificate obtained specifying the amount of such increase of capital stock, with his approval thereof, and that it has been duly paid in as part of the capital of such association."

It was as to the effect of the clause italicized above, so far as this statute is concerned, that the Court below divided. It is claimed by plaintiff in error that this Court has heretofore stated what the object of this statute was; how it may be violated; what is necessary to a valid increase of stock; and what conditions precedent must *concur* before any valid increase of stock in a National bank can be made.

"The clause in question" (Sec. 5142 *supra)* "was intended to secure the actual payment of the stock subscribed, and so to prevent what is called watering of stock."

Aspinwall v. Butler, 133 U. S. 595.

In the same case and in the same part of the opinion the Court said:

"This clause would have been violated by an issue of $500,000 of new stock when only $461,300 was paid in, but not by an issue of the exact amount that was paid in."

" 'Three things must concur to constitute a valid increase of the capital stock of a national banking association. First, that the association in the manner pointed out in its articles, and not in excess of the maximum prescribed by them, shall assent to an increased amount; second, that the whole amount of the proposed increase shall be paid in as part of the capital of the association; and third, that the comptroller of the currency, by his certificate specifying the amount of such increase of cap-

ital stock, shall approve thereof and certify to the fact of its payment.'"

Delano v. Butler, 118 U. S. 634, 649.

In the majority opinion below the interpretation of this statute (Sec. 5142) is worked out by first laying down four principles of statutory construction, found at folio 24, page 21, of the Transcript of the Record. We take no issue with these principles, but claim there is either no place for their application in this case, or that the majority of the Court below failed to apply its own rules to the case at bar.

It can hardly be held that the construction contended for by plaintiff in error, and so ably and clearly sustained in Judge Sanborn's dissenting opinion, is absurd or unjust or oppressive. The majority opinion, however, at folio 24, page 22 of the Transcript of Record, says: "Under the doctrine of these cases it is clear that in construing the particular clause of Section 5142, which declares that no increase of the capital stock shall be valid until the whole amount of the increase shall have been paid in, we must regard not only the words of the special clause, but also the other provisions of the entire act and the effect which a given construction will have upon the admitted or undoubted purposes of the statute as a whole." Section 5140, pertaining to the *original organization* of National banks, is then considered and at folio 25, page 23, the majority opinion says: "The argument of the defendant asks too much. It

would apply to the original capital of a company as well as to an increase of capital." We most respectfully suggest that this conclusion is wholly unwarranted and that the reason the majority so concluded was because it *did not follow the principle it had asserted, to-wit, construe Section 5142 "together with the provisions of the entire act."*

The bearing of the sections provided for the organization of banks upon the section provided for increase of capital was not argued before the Court below, and it is evident that the majority was not fully advised as to the statutes relating to organizations of banks. Had it considered Sections 5168 and 5169 of the act, together with 5140, the distinction between organization and increase of capital would have plainly appeared. By Sections 5168 and 5169 the comptroller is made a special tribunal "to examine into the condition of such association, ascertain especially the amount of money paid in on account of its capital," etc., and when it appears to the comptroller "that such association is lawfully entitled to commence the business of banking," etc., the comptroller shall issue his certificate authorizing the commencement of business. The findings of the comptroller after his examination and investigation is, in case of organization, conclusive on the stockholders. Further, there is no express condition precedent that none of the stock of the newly organized bank shall be valid unless fifty per cent is paid in. On the other hand, the statute providing for increase of capital does not constitute the comptroller a tribunal to

examine and determine whether the law had been complied with. He issues his certificate upon a mere notice—not even a sworn statement—from the bank that the law has been complied with, and his certificate is by the statute expressly made one of three conditions which must *concur,* as this Court has said in *Delano v. Butler, supra.* The Court below was unanimous that the comptroller's certificate was not conclusive in the matter of validity of increase. It did not even think the point, though urged upon the Court, was worthy of reference in its opinion and treated it just as this Court did when urged before it in *Delano v. Butler,* that is, as unworthy of consideration.

It would appear from the majority opinion in the Court below that it thought the decision of this Court in *Delano v. Butler,* 118 U. S. 634, had been modified by the subsequent cases of *Aspinwall v. Butler,* 133 U. S. 595; *Pacific National Bank v. Eaton,* 141 U. S. 227, and *Thayer v. Butler,* 141 U. S. 234, all cases growing out of the failure of the Pacific National Bank. But we submit that this Court has not modified by these later decisions the position it took in *Delano v. Butler, supra.*

Briefly stated, the facts in the Pacific Nat. Bank cases were as follows: It was voted to increase the capital of the bank from $500,000 to $1,000,000. Only $461,300 of the new capital was subscribed for and paid in. At the request of the directors, and with the sanction of a large majority of the stockholders the increase of capital was limited to the sum paid in, *i. e.,* $461,300, and that amount of in-

crease approved by the comptroller of the currency. The eleventh section of the by-laws of the bank provided that "if any stockholder fail to subscribe for the amount of stock to which he may be entitled, within a reasonable time, which shall be stated in the notice, the directors may determine what disposition shall be made of the privilege of subscribing for the new stock." The bank failed and those who subscribed for the new stock, when sued for assessments, defended on the ground, among others, that the new stock was invalid because the whole amount thereof had not been subscribed for and paid in. The subscription was held valid because, under the by-law, the directors had power to act in regard to the amount of the increase and in regard to the disposition of shares not subscribed for. No stock was issued that was not paid for. All the parties sued were old stockholders of the bank who subscribed for the new shares.

We submit that this Court has not only not modified, but has reasserted in these later cases the principles stated in *Delano v. Butler,* and Judge Sanborn's opinion on this point (folio 41, page 40 of Transcript of Record) seems unassailable. He says:

"I do not understand that the Supreme Court has modified or departed from its holding in the later cases of *Aspinwall v. Butler,* 133 U. S. 595; *Pacific Nat. Bank v. Eaton,* 141 U. S. 227, and *Thayer v. Butler,* 141 U. S. 234. In each of those cases the amount of increase originally proposed was $500,000, but only $461,300 was actually subscribed and

paid in. When this has been done, the bank modified its proposal, limited the amount of its increase to $461,300, notified the comptroller that this amount has been subscribed and paid in, and he issued his certificate for, and approved the increase, not of $500,000, but of $461,300. In this state of facts, the court held the increase valid. The key to these decisions is found, however, in the holding of the Court in *Delano v. Butler*, that the three conditions of the act of Congress had been exactly fulfilled. It said: 'In the present case the association did, in fact, finally assent to an increase of the capital stock, limited to $461,300; that amount was paid in as capital, and the comptroller of the currency by his certificate approved of the increase, and certified to its payment; so that there seems little room to question the validity of the proceeding resulting in such increase. All the requisitions of the statute were complied with. The circumstance that the original proposal was for an increase of $500,000 subsequently reduced to the amount actually paid in, does not seem to affect the question, for the amount of the increase within the maximum was always subject to the discretionary power of the association itself, exerted in accordance with its articles of association, and to the approval and confirmation of the comptroller of the currency.' 118 U. S. 649."

But we are confronted with another proposition. Section 5142, it is claimed, is so modified by Section 1 of the act of May 1, 1886, that "each subscription for portions of such increase when paid

up in full becomes valid and binding until the maximum is reached, and the statute does not incorporate into such subscriptions a condition that the subscriber, paying his subscription in full, cannot become a holder of valid stock unless the maximum amount of the proposed increase is subscribed for and paid in." (Folio 28, page 26, Transcript of Record.)

Section 1 of the act of May 1, 1886, (24 Statutes at Large, 18) provides:

"That any national banking association may, with the approval of the comptroller of the currency, by the vote of shareholders owning two-thirds of the stock of such association, increase its capital stock in accordance with existing laws, to any sum approved by the said comptroller, notwithstanding the limit fixed in its original articles of association and determined by said comptroller; and no increase of the capital stock of any national banking association, either within or beyond the limit fixed in its original articles of association, shall be made except in the manner herein provided."

The amendatory statute in no wise repeals Sec. 5142. It only adds thereto the requirement that the increase must be voted by the owners of two-thirds of the stock.

Winters v. Armstrong, 37 Fed. 508.

McFarlin v. First Nat. Bank, 68 Fed. 868.

In the case at bar two-thirds of the stockholders never voted for any increase except for the sum of $150,000. That was the amount selected by the

stockholders and that was the amount which the comptroller approved. Only $100,000 was paid in, $50,000 was watered stock. The stockholders never reduced the increase from $150,000 to $100,000, nor did the comptroller ever approve any such reduction. The only certificate given by the comptroller —one of the three conditions required—was a certificate specifying the amount of increased capital as $150,000. The statute says, "and no increase of capital shall be valid until the *whole* amount of *such* increase is paid in and" the comptroller's "certificate obtained, specifying the amount of *such* increase of capital stock," etc. The certificate of the comptroller specifies the amount of "*such increase*" as $150,000, and "no increase of capital shall be valid until the *whole* amount of *such* increase is paid in." How, then, can, as the majority below say, "each subscription for *portions* of *such* increase, when paid up in full" become "valid and binding." This Court in *Delano v. Butler, supra,* said that one of the necessary conditions for valid increase of stock was, "* * * second, that the whole amount of the *proposed* increase shall be paid in as part of the capital of the association."

It is further claimed that any construction of Section 5142, other than that given by the majority of the Court below, would work great injustice. At folio 27, page 25 of the Transcript of Record, speaking of defendant's contention, it said: "If this contention is well founded, then, as already said, it follows that if all the shares but one had been subscribed and paid for, nevertheless the holders of

the certificate for the full-paid shares could not be heard to assert that they were the owners of valid shares, which would be a most unjust result." Can we not, with equal right, say that, if the only increase proposed and the only increase specified by the comptroller is for $150,000.00, it would be great injustice to hold the whole amount of $150,000.00 valid stock when only $100.00 had been paid in? Can we not, with equal right, say that with such proposed increase of $150,000.00, it would be great injustice to hold that the person, who had taken one share and paid $100.00 under the express condition, as was the case at bar, that the whole $150,000.00 should be paid in, must keep this one share because it is valid, while the other $149,900, being invalid stock, must be cancelled? It is pretty hard to find any statute so perfect that imagination cannot conceive its working injustice to some individuals under some circumstances. But we maintain that the statute as interpreted in the dissenting opinion will cause less injustice than as interpreted in the majority opinion of the Court below. As this Court has said, it was to prevent watering of stock in National banks that this statute was enacted. It was to prevent frauds upon innocent subscribers to stock and to prevent banks doing business on fictitious capital that this statute was enacted, and can this be prevented by holding such fictitious stock to be valid? Congress has said such stock shall not be valid. It has so said in plain, unmistakable and emphatic words. It has not so said in ambiguous terms. What right has a

court to go outside of the plain words of a statute in order to read its own ideas of convenience and justice into a law? There is a fundamental principle of statutory construction which is often overlooked. It was stated by Mr. Justice Harlan as follows:

"Where the language of a statute is plain and unambiguous, it is the duty of the court to enforce it according to the obvious meaning of the words without attempting to change it by adopting a different construction, based upon some supposed policy of Congress in regard to the subject of legislation or upon consideration of injustice or inconvenience arising from the enforcement of the statute according to its terms." *Bates Refrigerating Co. v. Sulzberger,* 157 U. S. 1.

Another principle was stated by this Court in *Montclair v. Ramsdell,* 107 U. S. 152, as follows:

"It is the duty of the court to give effect if possible to every clause and word of a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed."

We submit that this statute should be interpreted "according to the obvious meaning of the words," and that, as even learned judges differ as to the injustice and inconvenience arising from the enforcement of the statute according to its terms," there is no occasion here for a construction based upon supposed injustice, inconvenience or oppression.

2. *Plaintiff in error is entitled to a rescission of his subscription contract.*

In reachingthe conclusion that plaintiff in error was not entitled to a rescission the majority of the Court of Appeals based that conclusion largely upon the premise that the liability of a stockholder to pay an assessment is "not dependent upon the terms or in fact upon the existence of a contract of subscription to the capital stock of the bank, but it is a liability imposed by statute in favor of creditors," (Transcript of Record, fol. 31, Judge Shiras' opinion); that "suits of this character, strictly speaking, are not actions based upon the contract of subscription existing between the corporation and the stockholders," (Transcript of Record, fol. 30), and "as already said, this suit is not based upon the contract of said subscription between the bank and the plaintiff in error and is not, therefore, an action wherein the issue can be made as to the voidability of that contract as between the bank and the shareholders." (Transcript of Record, fol. 33.)

This Court, in *Concord First Nat. Bank v. Hawkins*, 174 U. S. 364, and in *Whitman v. National Bank of Oxford*, 20 S. C. Rep. 479, has distinctly held that "the liability of a stockholder to an additional amount equal to his stock, though created by statute, is contractual in its nature."

Judge Sanborn, in his dissenting opinion, in reaching the conclusion that Scott is entitled to rescission, recognizes the contractual nature of the stockholders' liability; his opinion upon the ques-

tion of rescission is so comprehensive that we are satisfied to here reproduce it without addition or comment:

"The case made by the pleadings is this: In 1890 the plantiff in error was a stranger to the bank, free from all connection with or relation to it, and ignorant of its financial standing and character. The bank was insolvent, was earning no dividends and had no surplus. To induce the plaintiff in error to purchase some shares of a proposed increase of its worthless stock, the bank falsely represented to him that it was solvent and in a flourishing condition, that it was earning dividends on its stock, that it had a surplus of $50,000 above its capital stock and liabilities, and that its stock was worth a premium of $8.00 per share. By these misrepresentations it induced him to subscribe for 50 of the 1,500 shares it proposed to issue and to deposit with it $5,400 under an understanding that this money should be applied to the payment for this stock when the whole amount of the increase of stock was subscribed for and paid in. The entire amount was subscribed for, but only two-thirds of this increase was ever paid in. The bank then appropriated the plaintiff's $5,400 in payment for the 50 shares of stock, sent him a certificate of it, and induced him to play the role of a stockholder by the false representation that the entire increase had been paid in, and by the same false representation induced the comptroller of the currency to issue his certificate and approve the increase. At the same time it so falsified its books that the plain-

tiff in error could not by the utmost diligence learn the true condition of the bank. All this was done in October, 1890. But the bank continued to falsify its books, and to conceal the truth so that the plaintiff in error had no suspicion of the fraud and could not discover it by any reasonable diligence until after he had received two dividends on his supposed stock and the bank had closed its doors in 1894. Here is a case where a bank by the grossest false misrepresentations has induced a stranger to pay $5,400 and to incur a liability for $5,400 more, for a certificate of worthless stock that furnished no consideration for the contract. It is difficult to conceive of a grosser fraud. Upon every principle of equity and justice this subscriber was entitled to repudiate this purchase, to rescind his contract, and to recover back his money as soon as he discovered the facts. Contracts for stock in a corporation which are induced by fraud create no obligation, and the victim of the fraud has the right to their abrogation. *Vreeland v. N. J. Stone Co.*, 29 N. J. Eq. 190; *Thompson's Liability of Stockholders*, Sec. 142.

It is true that this contract was voidable and not void and that the duty to rescind it as soon as the facts were discovered, or as soon as they could be discovered with reasonable diligence, was imposed upon this subscriber. But he avers in his answer, and this allegation stands admitted in this record, that the bank, systematically, skillfully and cunningly falsified its books, concealed the facts, asd continued its false representations until it closed

in May, 1894, so that he could not with the utmost diligence discover the fraud,and so that he had no suspicion of it. How can he be said to be guilty of such negligence or laches as will deprive him of relief in the face of these facts? The statutes of the State of Missouri, where this fraud was perpetrated, provide that an action for relief on the ground of fraud may be brought at any time within five years ater the discovery by the aggrieved party, within ten years, of the facts constituting the fraud (Rev. Stat. Mo., 1889, Sec. 6775), and it is a familiar maxim that no time runs against the victim of a fraud while its perpetrator fraudulently and successfully conceals it. Scheftel v. Hays, 58 Fed. Rep. 457, 460, 7 C. C. A. 308, 312, 19 U. S. App. 220. 226; Kelley v. Boettcher, 85 Feb. Rep. 53, 63. I am unable to escape conviction that under this state of facts this subscriber was entitled to rescind the purchase of, and to repudiate the liability upon this stock.

It is conceded in the opinion of the mapority that as against the bank the plaintiff in error would be entitled to this relief, but it is insisted that by his delay in seeking it, and by his receipt of two dividends he is estopped from obtaining it as against the receiver, because the latter represents the creditors of the bank as well as the bank itself. In support of this view the cases of Chubb v. Upton, 95 U. S. 665, Veeder v. Mudgett, 95 N. Y. 295, Stutz v. Handley, 41 Fed. Rep. 531, Pauly v. State Loan & Trust Co., 165 U. S. 606, and Keyser v. Hitz, 133 U. S. 138, are cited. But there seems to me to be a radi-

cal difference between the standing of the subscriber in this case and that of the subscribers in Chubb v. Upton, Keyser v. Hitz, Upton v. Tribilcock, 91 U. S. 45, Sanger v. Upton, 91 U. S. 56, 63, and other cases of that class. In this case the plaintiff in error was induced to purchase by a gross and continuing fraud which kept him in ignorance of the facts, and rendered it impossible for him to discover them by the use of reasonable diligence. In those cases the subscriptions were not induced by fraudulent, continued and successful misrepresentations and concealments of material facts which lulled suspicion and hid the truth, but the defenses were the defective exercise of the power to issue stock as in Chubb v. Upton, the defective transfer of stock as in Keyser v. Hinz and Sanger v. Upton, 91 U. S. 63, a misrepresentation as to the legal effect of the stock certificate which purported to be nonassessable, which was held to be a misrepresentation of a matter of law and unavailable, as in Upton v. Tribilcock, 91 U. S. 45, 50, the fact that an increase of stock was irregularly, but not fraudulently issued and knowingly retained, as in Veeder v. Mudgett, 95 N. Y. 295, 310, and Stutz v. Handley, 41 Fed. Rep. 531, that subscribers or pledgees knowingly held themselves out as owners of stock "in such way and under such circumstances as upon principles of fair dealing will estop them as against creditors from claiming that they were not in fact owners" as was said in speaking of supposed cases in Pauly v. State Loan & Trust Co., 16 U. S. 606, 623, and that subscriptions were knowingly ratified and

adopted after full knowledge of the falsity of the statements which induced them, as in Ogilvie et al. v. Knox Ins. Co. et al., 22 How. 380, 390. In these cases the subscribers or holders were held to be estopped as against the creditors because they continued to act as stockholders after they knew, or by the exercise of reasonable diligence might have known the facts. None of them were tricked into the place of stockholders and retained there by a continued fraud which kept them in ignorance of, and rendered it impossible for them to learn the truth by the exercise of reasonable diligence, as the plaintiff in error was in the case at bar. This is the radical distinction between the cases referred to and that in hand. It separates by as wide a difference the cases of Scovill v. Thayer, 105 U. S. 193, Sawyer v. Hoag, 17 Wall. 610; Albany v. Burke, 11 Wall. 96, Burke v. Smith, 16 Wall. 390, Mumma v. Potomac Co., 8 Pet 281, Delano v Butler, 118 U. S. 634, National Bank v. Case, 99 U. S. 628, Bowden v. Johnson, 107 U. S. 251, and Potts v. Wallace, 146 U. S. 689, 703, cited in the opinion of the majority. It is held in those cases that those who knowingly permit themselves in various ways to appear to be stockholders, those who were stockholders but presented the false appearance that they were not, and those who fraudulently transferred their stock to irresponsible parties to escape liability were estopped from defeating creditors of the corporation in their attempt to hold them as such. It is indeed repeatedly said in those cases that the property of an insolvent corporation and the liabil-

ity of the stockholders is a trust pledged for the benefit of the creditors, and that is equally true of every insolvent person. But in none of these cases, in no case cited by the court or the counsel was the holder of the stock duped into his place and liability by undiscovered fraud. In none of them did any court hold that money obtained from, or liability imposed upon, a stockholder by fraud which he could not discover, was a trust fund held for the benefit of the creditors of the corporation which perpetrated the fraud. Can a debtor by fraud confer upon his creditors any greater right to the property or liability of his victim than he gets himself? In the opinion of the majority this question is propounded: "If A., being the owner of fifty shares of the capital stock in a bank, should induce B. to purchase the same through false representations with respect to the financial condition of the bank, the stock being transferred to B. on the books of the association, could B., if the bank subsequently failed, escape liability to the creditors on the ground that he had been induced to purchase the stock through the false representations made by A.?" In my opinion, in the absence of other proof of an estoppel *in pais*, the question should be answered in the affirmative, because fraud avoids every purchase, every sale, every contract, as against every one but an innocent purchaser or creditor who has taken his place in reliance upon it. That, however, is not the question in this case. The question here is: Could the assignee or receiver of B's property, in the case of the sale supposed, enforce a non-nego-

tiable obligation of A., which B. had induced him to make by the fraudulent misrepresentations? Regarding the answer to this question it seems to me there ought not to be two opinions. If a debtor procures goods by false representations, the right of the defrauded vendor to recover them are always superior to those of the creditors of the vendee or the receiver who represents them. *A fortiori* if, by the fraudulent representations by which he sells his goods, he procures an assumption of liability by the vendee, the right of the latter to a rescission of the sale and a cancellation of the obligation is superior to the rights of either his creditors or his receiver to enforce it. Beach on Receivers, Sec. 704; Litchfield Bank v. Peck, 29 Conn. 384, 386; Bussing et al. v. Rice, 2 Cush. 48; Rohrbough v. Leopold, 68 Tex. 254, 258; Root v. French, 13 Wend. 570, 573; Barnard v. Campbell, 58 N. Y. 73; Slagel v. Goodnow, 45 Minn. 531; Oswego Starch Factory v. Lendrum, 57 Ia. 573, and cases there cited; Atwood v. Dearborn, 1 Allen 483; Devoe v. Brandt, 53 N. Y. 462, 465; Benjamin on Sales § 433, Note I. Why is not the right of one who is induced by the fraudulent misrepresentations of a bank to buy stock, to a rescission of that sale and a release of the liability it imposes, superior to the claims of its creditors or its receiver to enforce them? Fraud vitiates every contract based upon it. A contract of subscription for, or purchase of, stock, is no exception to the rule, and the relation and liability of a stockholder cannot exist without the existence or an estoppel from denying the existence, of the

contract of subscription or purchase. It is true, as is shown in Scovill v. Thayer, and other cases citted, that the stockholders' liability and the maintenance of the action upon it is not dependent upon the terms of the contract of subscription where those terms are in conflict with the law or the statute, as was the contract that the stock was nonassessable, but the existence of a valid contract of subscription or an estoppel from denying its existence is a *sine qua non* to the existence of the liability and the maintenance of the action. Without it there can be no stockholder, and hence, no liability of a stockholder. And, where the contract is induced by fraud, and is rescinded without negligence or delay as soon as the facts constituting it are discovered, it is as though it had not been, and there remains neither contract nor stockholder, nor liability of a stockholder. In all the cases that have been cited in which the liability was enforced a contract of subscription of purchase which had not been induced by fraud, or which had been ratified after its discovery, existed, and the stockholders in those cases were held because, as was well said in Pauly v. State Loan & Trust Co., 165 U. S. 606, 623, they were the real owners of the stock or held themselves out or "allowed themselves to be held out as owners in such way and under such circumstances as, upon principles of fair dealing, will estop them, as against creditors, from claiming that they were not in fact, owners." But one who is induced by a continuing fraud to subscribe for, or to purchase and to retain stock is not estopped as against creditors on prin-

ciples of fair dealing from repudiating the contract and liability when he discovers the facts, because he has never knowingly or negligently deceived them to their injury. So are the American authorities that have treated of such fraudulent contracts, (Newton National Bank v. Newbegin, 40 U. S. App. 1, 20 C. C. A. 339, 74 Fed. Rep. 135; Florida Land & Improvement Company v. Merrill, 52 Fed. Rep. 77, 80; Upton v. Thibilcock, 91 U. S. 54; Winters v. Armstrong, 37 Fed. Rep. 516, 517; Duffield v. Barnum, 31 N. W. Rep. (Mich.) 310, 316), and they clearly mark and strongly emphasize the distinction between the cases relied upon in the opinion of the majority and that now before us. In all the cases cited by the majority either a valid contract of subscription or purchase existed, or the stockholders were estopped from rescinding a voidable contract because they had acted as such after they knew or might have known the facts upon which they relied to avoid it. In the case at bar the contract was induced by fraud and it was concealed by fraud. In this case no estoppel against the plaintiff in error can be sustained because he did not know, and could not learn the facts, and no duty to speak or act rested upon him until he acquired that knowledge or means of knowledge. It may be that upon a trial of this case evidence could be adduced which would estop him from repudiating the purchase of this stock, but upon the admitted allegations of his answer here, there are several reasons why I think he is not barred as against this receiver and the creditors he represents from obtaining the relief he seeks.

An estoppel arises only when one knowingly or negligently represents to another who is ignorant and relies and acts upon the representation to his injury that a fact or condition exists, which has no existence. An essential element of such an estoppel is a wilful intent to deceive, or such gross negligence of the rights of others as is tantamount thereto. There must be some moral turpitude or some breach of duty. Henshaw v. Bissell, 18 Woll. 255, 271; Bank v. Farwell, 58 Fed. Rep. 633, 636, 639, 7 C. C. A. 391, 394, 396, 19 U. S. App. 256, 262, 265; N. Y. Life Ins. Co. v. McMaster, 87 Fed. Rep. 63, 66. Mr. Justice Field, speaking of his estoppel in Henshaw v. Bissell, says: "For its application there must be some intended deception in the conduct or declarations of the party to be estopped, or such gross negligence on his part as to the amount to constructive fraud. An estoppel *in pais* is sometimes said to be a moral question. Certain it is that to the enforcement of an estoppel of this character, such as will prevent a party from asserting his legal right to property, there must generally be some degree of turpitude in his conduct which has misled others to their injury. Conduct or declarations founded upon ignorance of one's right have no such ingredient, and seldom work any such result." As long as the plaintiff in error did not know and could not learn by the use of reasonable diligence the facts constituting the fraud upon him until after the bank had incurred its debts to all its creditors, he was not guilty of any breach of duty to them or of any negligence of their rights, or of any intent to

deceive them and they cannot sustain the plea of an estoppel against him.

Another requisite ingredient of an estoppel by conduct or declarations is, that the party claiming its benefit has acted upon it in such a way, that he will be injured if the natural inference from it is denied. The deceit of the victim of the representations and consequent damage from their denial are indispensable to the existence of the estoppel. N. Y. Life Ins. Co. v. McMaster, 87 Fed. Rep. 63, 66; Bonsack Machine Co. v. S. F. Hess & Co., 68 Fed. Rep. 119, 135, 15 C. C. A. 303, 318, 25 U. S. App. 315, 341. There is nothing in this record to show that any creditor of this bank loaned his money to it or deposited his funds with it in reliance upon the fact that the plaintiff in error appeared to own fifty shares of stock in it, and I am aware of no presumption of law or of fact which makes it our duty to reach this conclusion in the absence of pleading and proof.

Moreover an estoppel does not operate in favor of everybody. No one can set it up or derive any benefit from it, who has not been misled by the misrepresentation or conduct to his injury. Ketchum v. Duncan, 96 U. S. 659, 666; The Howard Carrol, 14 U. S. App. 506; Harris in re., 57 Fed. Rep. 243, 246, 6 C. C. C. 320. If it were conceded that a creditor of the bank who was induced to become such by his reliance upon the fact that the plaintiff in error appeared to have fifty shares of stock could estop him from escaping from a liability thereon, that estoppel could not inure to the benefit of any creditor

who was not induced to become such, in reliance upon that fact. If there were some creditors who were, and some who were not induced to become such in reliance upon this fact, the receiver could not derive any benefit from it in this suit because he can enforce only the common rights and claims of individual creditors, and he cannot plead or urge the personal claims of individual creditors which are not common to all. He cannot enforce an estoppel which may belong to one-third or one-tenth of the creditors and distribute the proceeds he derives from it among them all. The right of a creditor to enforce such an estoppel is a personal right which no one but the creditor misled by the representation can urge and the receiver cannot avail himself of it, unless all the creditors have been induced to loan their money to this bank by the apparent ownership of its stock by the plaintiff in error. There is neither plea nor evidence of such a state of facts in this case. Indeed the pleadings show that when this stock was subscribed, the bank owed more than the value of all its assets. A state of things once shown to exist is presumed to continue, and where, as in this case, it appears that a bank owed more than the value of all its property in 1890 and again in 1894, the presumption that it had paid all of its creditors and become indebted to new ones during this four years would be contrary to the common experience and observation of business men, violent and unreasonable. The strong probability is, that most of the creditors of this bank loaned their money to it prior to 1890, and they surely cannot plead an

estoppel. Whether they did or not, I am strongly of the opinion that the plaintiff in error is entitled to pleading and proof that some or all of these creditors loaned their money in reliance upon his ownership of the stock before an estoppel against him is found. "A creditor who has been defrauded by misrepresentation of the real capital of the company has his remedy in an action of tort against all who participated in the fraud. But the wrong done to him cannot entitle the entire body of creditors, who have not suffered from the alleged fraud, to recover of the entire body of stockholders, who have taken no part in it." Scovill v. Thayer, 105 U. S. 143, 151.

Finally, even if the fact were established that a creditor loaned his money since 1890 in reliance on the ownership of the stock of the plaintiff in error, I am unable to perceive any right or equity in his claim superior to that of the plaintiff in error. In that case they were both deceived by the same fraud. They were both kept in ignorance of the actual facts by the same falsifications and devices, and I see no reason why one of the victims of such a wrong should be allowed to prey upon the other. The bank induced the plaintiff in error to play the part of a stockholder, and thereby to lose all the money he deposited with it and to run the risk of liability to lose as much more by the same scheme of false representations of its solvency, of its flourishing condition, and of its increase of stock which doubtless induced the creditor to take the bank's promise of repayment for the money he deposited with it. In such a case, why should not the right of the pur-

chaser of stock who suffers the greater wrong, be equal to that of the creditor who suffers less? Neither of them did or could discover it, until both were injured. Neither of them knowingly or negligently deceived the other, and in my opinion neither of them is entitled to estop the other from undoing the fraud from which they suffer. Newton Nat. Bank v. Newbegin, 74 Fed. Rep. 135, 140, 20 C. C. A. 339, 344; Florida Land, etc., Co. v. Merrill, 52 Fed. Rep. 77, 80, 2 C. C. A. 629, 632; 2 U. S. App. 434, 439, 440; Upton v. Tribilcock, 91 U. S. 45, 54; Winters v. Armstrong, 37 Fed. Rep. 512, 516, 517; Duffield v. E. T. Barnum Wire & Iron Works, 31 N. W. Rep. (Mich.) 310, 316.

3. *The only contract made by Scott was a subscription for 50 shares of valid stock of a proposed increase of $150,000 of valid stock.*

Defendant subscribed for shares of the proposed increase of $150,000.00. The law requires that a subscriber pay his money into the bank before the stock is created. The defendant subscribed to this increase and paid his money in with the understanding and agreement and with the conditions precedent to the obligation becoming binding upon him as a subscriber, that all of this $150,000.00 be subscribed for and that it all be paid in. Defendant's subscription was a conditional subscription and the conditions imposed are not only not in fraud of the law, but actually imposed by the law. It is admitted that these conditions were never performed by the bank and the pleadings show that performance was

never waived. Scott never consented to be bound by any subscription contract except the one requiring that $150,000.00 of new stock be subscribed for and paid in. That is the only contract, too, of which the receiver here can avail himself in this action. The court cannot make a contract of subscription. It must deal with the defendant as it finds him, either as a stockholder or not as a stockholder. It cannot make a new contract of subscription in order to make stockholders. It cannot make a conditional subscription unconditional, so long as the conditions are valid and not against public policy. So far as the rights of this receiver with reference to Scott are concerned he stands in exactly the same position as the bank itself stands when it is a question of whether or not a subscription contract has ripened into stock ownership. (Winters v. Armstrong, 37 Fed. 521; Eaton v. Pacific Nat'l., 144 Mass. 260, 10 N. E. 850; McFarline v. 1st Nat'l., 68 Fed. 868.

Respectfully submitted,

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